



American Subcontractors Association

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Save Time, Save Money, Know Your Standard Construction Contract
(The Importance of Designating in an AIA Contract that the Federal Arbitration Act is the Choice of Law Governing All Disputes Subject to Arbitration)

By Heather Shore, Esq.* and Travis Wymore, Esq.* of Brown & Ruprecht, PC

The use of standard form American Institute of Architects (AIA) commercial construction contracts has become pervasive throughout the construction industry. AIA contracts can save contractors and their counsel the time and expense of preparing construction contracts from scratch. An additional incentive for their use is that courts have developed a relatively uniform body of law with respect to the interpretation of AIA contracts.

One of the pervasive themes embraced by the AIA contracts is their preference for arbitration as the designated means of dispute resolution. The construction industry has embraced arbitration because the complexity of the issues and the number of documents often involved in construction disputes can make arbitration more cost effective and efficient than trial to a jury or even to a judge. Unfortunately, certain clauses in the 1997 (and prior) version of the AIA contracts have created an ambiguity in the interpretation of whether matters should be submitted to arbitration. The 1997 (and prior) version of the AIA contracts are still routinely used by contractors despite the fact that the 2007 version is now available for use. Unfortunately, the 1997 (and prior) version has precipitated significant litigation pertaining to the issue of the arbitrability of the parties' dispute, based upon certain ambiguities in the contract documents.

Specifically, the ambiguities arise primarily from a general choice of law clause contained in the 1997 AIA contract that states the law of the state where the project is located applies to disputes. Most practitioners agree that the choice of law clause governs which state's substantive law applies when actually resolving the dispute (*e.g.* the underlying breach of contract or tort claim). However, there is significant disagreement as to whether that state's law also governs the interpretation and application of the arbitration clause within the contracts. This has been a hotly contested issue for over 20 years.

Parties favoring arbitration tend to prefer the application of federal law, namely the Federal Arbitration Act, to determine if the parties' claims are arbitrable. Once in arbitration, the choice of law clause governs which state's substantive laws the arbitrator will apply to resolve the actual dispute. Generally, this is a more consistent method of interpreting the arbitration clause in the AIA contracts because the Federal Arbitration Act provides a more desirable and streamlined means of resolving conflicts arising from a construction contract. Furthermore, federal law favors arbitration and provides an affective procedural framework in which to resolve arbitration disputes. Under the Federal Arbitration Act, if there is a binding arbitration agreement in a contract, then the only inquiry that a court is allowed to make in those cases where a party has challenged a demand for arbitration is (1) whether a valid

* Heather Shore is a shareholder with the law firm of Brown & Ruprecht, PC, located in Kansas City, Missouri. She is licensed in Kansas, Missouri and Colorado. She may be contacted at 816-292-7000, or by e-mail at hshore@brlawkc.com.

* Travis Wymore is an associate with the law firm of Brown & Ruprecht, PC, located in Kansas City, Missouri. He is licensed in Missouri and Kansas. He may be contacted at 816-292-7000, or by e-mail at twymore@brlawkc.com.

arbitration clause exists in the contract and (2) whether the disputed issue falls within the class of disputes covered by the clause. If both of these questions are answered in the affirmative, under the Federal Arbitration Act the case must be sent to arbitration. All other issues, including whether the terms of the contract are void or voidable, whether one party breached the contract, or whether one party fraudulently induced the other party to enter into the contract, are for the arbitrator to decide. Thus, even if one of the parties argues that the entire contract is invalid, that issue is for an arbitrator, not for a court, to decide.

However, parties who desire to avoid arbitration, even in the face of a valid arbitration clause, typically argue that the Federal Arbitration Act does not apply. Instead, these parties argue that choice of law clause applies not only to the underlying claims, but also to the application and interpretation of the arbitration clause. This can have expensive and dire consequences for the party seeking to enforce the arbitration clause. For instance, under the Missouri Uniform Arbitration Act, a party challenging an arbitration clause contained in a contract may be entitled to an evidentiary hearing which could potentially result in an order forcing the parties to litigate, rather than to arbitrate, claims based on fraud or other disputes between them. This process and outcome is drastically different from the procedural mechanisms set forth under the Federal Arbitration Act, where the question of arbitrability is within the jurisdiction of the arbitrator, and not within the jurisdiction of the court. Thus, if a party challenges the arbitrability of a contract and the applicability of the Federal Arbitration Act, resolving that issue can be very expensive and time consuming.

The U.S. Supreme Court has recently attempted to resolve this dispute. The Court stated that the choice of law clause mandates that state law applies to the resolution of the underlying claims. However, because construction contracts implicate interstate commerce, and because the Federal Arbitration Act governs all arbitration disputes involving interstate commerce, the choice of law clause does not mandate state law for interpreting and applying the arbitration clause. Instead, the Federal Arbitration Act is used to determine whether the parties' disputes must be submitted to arbitration. Once the case is submitted to arbitration, then the rules agreed to by the parties to govern their dispute (*i.e.*, the AAA rules), and not the state rules, govern the actual procedures followed in the arbitration.

In response to the significant litigation over the issue of arbitrability and following the Supreme Court's guidance on this issue, the most recent versions of the AIA contracts, dated 2007, have revised the choice of law clause as follows: "[This AIA] Contract shall be governed by the law of the place where the Project is located except that, if the parties have selected arbitration as the method of binding dispute resolution, the Federal Arbitration Act shall govern." Thus, if a contractor uses the standard 2007 AIA contract, the contractor can anticipate (1) that the Federal Arbitration Act will be used to determine if the parties' claims and disputes are arbitrable, (2) that once in arbitration, the arbitrators will apply the American Arbitration Association arbitration rules, and (3) that the choice of law clause will determine which state's substantive laws will be applied to resolve the parties' dispute. However, it is important to note that not all construction contracts utilize the most up-to-date AIA contract documents. Thus, if the 1997 version is being used by a general contractor, the careful subcontractor will insist that the choice of law clause be amended to state that the Federal Arbitration Act governs in the context of arbitration. Otherwise, a subcontractor runs the risk of hiring an attorney, not just to resolve the underlying dispute, but also to enforce the arbitration clause contained in the parties' subcontract.